

difficulty of achieving the Balanced Budget Act's original deficit target of \$108 billion. Because Congressional action is incomplete, it is too early to predict the 1988 budgetary tallies. But three sets of projections may be compared (see Table II-2):

TABLE II-2. DIFFERENCES AMONG CBO BASELINE, BASE FOR SEQUESTRATION, AND BUDGET RESOLUTION FOR FISCAL YEAR 1988 (In billions of dollars)

	Revenues	Outlays	Deficit
CBO Baseline	897	1,080	183
Differences			
Exclusion of discretionary inflation and other adjustments to 1987 appropriation levels			
Defense programs		-5	-5
Nondefense programs		-8	-8
Adjustment in net interest costs		a /	a /
Total differences	0	-13	-13
Base for Balanced Budget Act	897	1,067	170
Differences			
Assumed spending changes			
Defense programs		3	3
Nondefense programs		-4	-4
Assumed revenue increases	21		-21
Adjustments in net interest costs		-1	-1
Total differences	21	-2	23
Budget Resolution Policies	918	1,064	146

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

- o The CBO baseline. Without further policy changes, the 1988 deficit is expected to be \$183 billion.
- o The base for sequestration. The starting point for calculating across-the-board spending cuts under the Balanced Budget Act currently excludes certain inflation adjustments that are included in the baseline, in effect freezing many programs at 1987 dollar levels. The resulting deficit is \$170 billion, \$13 billion lower than the baseline.
- o The budget resolution. The taxing and spending blueprint adopted by the Congress in June would reduce the 1988 deficit to about \$146 billion, or \$37 billion below the baseline.

The Baseline. The baseline shows where the budget is headed if current taxing and spending policies remain unchanged. It is not a prediction of future budgets, which will doubtless include numerous policy changes.

An earlier report, *The Economic and Budget Outlook: Fiscal Years 1988-1992* (January 1987), described in detail the methods and assumptions used by CBO to project the budget under current policies. Generally, federal government revenues as well as spending for programs like Social Security, Medicare, and other entitlements are projected according to laws now on the books. The revenue projections, however, assume the extension of certain trust fund taxes beyond their currently scheduled expiration dates--namely, Airport and Airway Trust Fund taxes in 1987 and Hazardous Substance Superfund taxes in 1991. Many government activities are funded annually through the appropriation process; for these programs, 1987 funding levels are adjusted for inflation. Finally, offsetting receipts (for example, receipts from oil leases) are estimated in light of current laws and policies, and net interest payments in light of the assumed interest rates and deficits.

The baseline projections for 1988 are shown in Table II-1. Revenues of \$897 billion are only about 5 percent higher than 1987's projected totals, largely because the first-year gain from tax reform is temporarily reversed. Spending in categories other than nondefense discretionary and interest also increases about 5 percent in the aggregate. (Detailed projections of spending by category appear later in Table II-4.) But interest outlays rise 9 percent in response to recent increases in interest rates and continued deficit financing, and nondefense discretionary outlays increase by 12 percent as one-time savings in 1987 disappear. Total outlays reach \$1,080 billion, and the projected baseline deficit is \$183 billion.

Base for Sequestration. The Balanced Budget Act of 1985 provides for across-the-board cutbacks when projected deficits exceed the law's targets. The act also mandates very specific assumptions to be used in projecting the deficits when Congressional action on the budget is not final. These assumptions differ somewhat from those used for the baseline. The main difference affects assumptions about appropriations. In the absence of final Congressional action, the base for sequestration must assume no change from the amounts appropriated for 1987--even to reflect inflation--whereas the baseline contains such adjustments. Base outlays for possible sequestration in 1988 are estimated at \$1,067 billion, revenues at \$897 billion, and the deficit at \$170 billion. Table II-2 shows differences among the baseline, the budget resolution, and the starting point for sequestration in 1988.

To reach the Balanced Budget Act's original deficit target wholly through sequestration, the Congress would need to approve across-the-board reductions of almost one-fifth in defense budgetary resources and one-fourth for nondefense programs. These percentages are very high because many programs are exempt from sequestration, and because the lags in government spending require large changes in spending authority to achieve short-run outlay savings.

The percentage reductions eventually considered by the Congress may differ from these for three reasons. First, the law requires that across-the-board reductions depend on an average of CBO and OMB projections; the two agencies often differ for economic and technical reasons and over interpretation of the law. Second, the law requires a second report by the two agencies in early October. That report will reflect any Congressional action accomplished by that time. Third, the law may be changed to permit a higher deficit target or to limit the maximum sequestration in 1988. Other changes in the law may modify the calculation of the base deficit, for example, by reinstating inflation adjustments or resolving the current disagreements in interpreting the law.

Congressional Budget Resolution. The Congressional budget resolution, if fully implemented, would reduce the 1988 deficit to \$146 billion--about \$37 billion lower than the baseline. In September, Congressional committees are to report deficit reductions totaling \$30 billion to comply with their reconciliation instructions. These reconciliation savings mainly boost revenues and governmental fees and reduce entitlement programs (such as farm price supports and Medicare). The remaining savings ordered by the budget resolution are to occur primarily in the appropriation process this fall. More detail about the savings in the budget resolution for 1988 and subsequent years appears later in this chapter.

 THE BUDGET OUTLOOK THROUGH 1992

Without further changes in budgetary policies, 1987's striking deficit improvement will prove ephemeral. The baseline deficit is projected to increase in both 1988 and 1989, before declining slightly. Moreover, it will remain above \$150 billion through 1992. As a percent of GNP, the deficit climbs to almost 4 percent in 1988 and 1989 before declining to 2.5 percent in 1992. These deficit projections are more pessimistic than estimates made earlier this year, primarily because of lower economic growth and higher interest rates.

Table II-3 shows the updated projections of revenues, outlays, and the deficit. By showing separate totals for on- and off-budget revenues and

TABLE II-3. CBO BASELINE PROJECTIONS OF REVENUES,
OUTLAYS, AND DEFICITS (By fiscal year,
in billions of dollars)

	1987	1988	1989	1990	1991	1992
Total (Including Social Security)						
Revenues	853	897	954	1,036	1,115	1,195
Outlays	1,010	1,080	1,146	1,212	1,280	1,345
Deficit	157	183	192	176	165	151
On-budget (Excluding Social Security)						
Revenues	639	655	694	752	808	867
Outlays	816	876	929	981	1,035	1,087
Deficit	177	221	236	229	227	219
Off-budget (Social Security)						
Revenues	213	242	260	284	307	327
Outlays	194	204	216	230	244	259
Surplus	19	38	44	54	63	69

SOURCE: Congressional Budget Office.

spending, Table II-3 also underscores the extent to which growing surpluses in the Social Security program help to hold down the overall deficit. Table II-4 augments the summary information on these latest projections, showing revenues by source and spending by category.

In the past few years, the Congress has enacted several pieces of legislation that result in fairly sharp year-to-year swings in revenues and outlays. As discussed below, without these unusual factors the deficit would be much higher in 1987 but would decline steadily--as a percent of GNP--thereafter.

Revenues. Because most federal government tax dollars come from individual income and payroll taxes and corporate income taxes, revenues depend heavily on the economy. In fact, in the absence of tax reform, revenues would average a steady 19.3 percent to 19.4 percent of GNP throughout the 1988-1992 period (Table II-5), up from 18.9 percent in 1987. Revenues would grow slightly faster than GNP because of scheduled Social Security tax increases in 1988 and 1990, and because taxpayers would move gradually into higher brackets as economic growth continues.

As Table II-5 shows, however, tax reform significantly affects the annual revenue path. Tax reform boosted revenues an estimated \$20 billion in 1987 but will lower them by \$12 billion and \$18 billion in 1988 and 1989, respectively, measured relative to prior law. Tax reform raises corporate income taxes in every year--by amounts ranging from \$19 billion in 1987 (including the cash effects of the retroactive repeal of the investment tax credit) to \$27 billion in 1992. In 1990 and later, the increasing corporate tax burden is approximately offset by individual income tax reductions. But reductions in tax rates on personal income dominate the revenue-raising elements of tax reform in 1988 and 1989, causing tax reform to depress revenue growth in those years.

Revenues are now projected to be lower in all years (except 1987) than estimates published in February. As Table II-6 shows, the macroeconomic forecast is the main reason for the changes. The revisions reflect slower economic growth and a revised distribution of national income among the major tax bases. Personal income as a share of GNP is higher, and corporate profits lower, than projected in February. The upward revisions in the personal income share are almost exclusively in less heavily taxed sources of income, particularly interest and entrepreneurial income. Both wage and profit levels are down for most of the forecast period, driving down receipts from personal income, payroll, and corporate income taxes.

TABLE II-4. UPDATED CBO BASELINE PROJECTIONS FOR FISCAL YEARS 1987 THROUGH 1992

	1986 <u>a/</u>	1987	1988	1989	1990	1991	1992
In Billions of Dollars							
Revenues							
Individual income	349	393	393	422	462	502	544
Corporate income	63	85	99	107	121	130	139
Social insurance	284	302	331	351	379	407	432
Other	73	74	74	74	75	76	79
Total	769	853	897	954	1,036	1,115	1,195
Outlays							
Defense	273	280	291	305	318	333	348
Entitlements	457	477	506	541	577	618	661
Nondefense discretionary	170	168	189	198	209	215	222
Net interest	136	137	150	161	170	179	184
Offsetting receipts	-47	-52	-56	-59	-62	-66	-69
Total	990	1,010	1,080	1,146	1,212	1,280	1,345
Deficit	221	157	183	192	176	165	151
Debt Held by the Public	1,746	1,901	2,077	2,266	2,440	2,601	2,750
As a Percent of GNP							
Revenues							
Individual income	8.3	8.9	8.3	8.4	8.6	8.7	8.9
Corporate income	1.5	1.9	2.1	2.1	2.2	2.3	2.3
Social insurance	6.8	6.8	7.0	7.0	7.0	7.1	7.0
Other	1.7	1.7	1.6	1.5	1.4	1.3	1.3
Total	18.4	19.3	19.0	18.9	19.3	19.4	19.5
Outlays							
Defense	6.5	6.4	6.2	6.1	5.9	5.8	5.7
Entitlements	10.9	10.8	10.7	10.8	10.7	10.7	10.8
Nondefense discretionary	4.1	3.8	4.0	3.9	3.9	3.7	3.6
Net interest	3.2	3.1	3.2	3.2	3.2	3.1	3.0
Offsetting receipts	-1.1	-1.2	-1.2	-1.2	-1.2	-1.1	-1.1
Total	23.6	22.9	22.9	22.8	22.5	22.3	21.9
Deficit	5.3	3.6	3.9	3.8	3.3	2.9	2.5
Debt Held by the Public	41.7	43.1	44.0	45.0	45.4	45.3	44.8
Memorandum: GNP (In billions of dollars)	4,189	4,409	4,718	5,035	5,380	5,747	6,141

SOURCE: Congressional Budget Office.

NOTE: Includes Social Security revenues and outlays, which are off-budget.

a. Actual.

As shown in Table II-6, technical revisions since last February raise estimated revenues by \$9 billion to \$10 billion a year after 1987. These revisions stem mainly from newly available, detailed data on taxable incomes and taxpayer behavior. No legislation with significant effects on baseline revenues has been enacted since February.

Outlays. The major changes to last winter's outlay projections come from the economic forecast. Higher interest rates account for almost all the upward revision in 1988, and for well over half of the economic reestimates from 1988 through 1992. The remaining economic reestimates mainly reflect higher cost-of-living adjustments (costing a negligible amount in 1988 but \$6 billion by 1992) in programs pegged to the Consumer Price Index. Smaller changes reflect adjustments for higher inflation in other programs and, as offsets, greater oil receipts and lower unemployment insurance outlays. Finally, debt service costs rise substantially to reflect the added borrowing necessitated by the other reestimates to revenues and outlays.

TABLE II-5. EFFECT OF THE TAX REFORM ACT OF 1986 ON CBO
REVENUE PROJECTIONS (By fiscal year)

	1987	1988	1989	1990	1991	1992
In Billions of Dollars						
Baseline Revenues Without Tax Reform	833	909	972	1,040	1,113	1,191
Effects of Tax Reform	20	-12	-18	-5	2	4
Baseline Revenues	853	897	954	1,036	1,115	1,195
As a Percent of GNP						
Baseline Revenues Without Tax Reform	18.9	19.3	19.3	19.3	19.4	19.4
Baseline Revenues	19.3	19.0	18.9	19.3	19.4	19.5

SOURCE: Congressional Budget Office.

TABLE II-6. CHANGES IN CBO BASELINE PROJECTIONS SINCE
FEBRUARY 1987 (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Revenues						
Winter Estimate	834	900	962	1,051	1,139	1,222
Economic Reestimates	-7	-12	-17	-25	-32	-38
Technical Reestimates	26	9	9	9	9	10
Enacted Legislation	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>
Total	<u>19</u>	<u>-3</u>	<u>-8</u>	<u>-15</u>	<u>-24</u>	<u>-28</u>
Summer Estimate	853	897	954	1,036	1,115	1,195
Outlays						
Winter Estimate	1,010	1,071	1,126	1,188	1,248	1,306
Economic Reestimates						
Interest Rates	<u>a/</u>	10	12	13	16	18
Cost-of-Living						
Adjustments	<u>a/</u>	<u>a/</u>	3	4	5	6
Debt Service	<u>a/</u>	1	4	7	11	15
Other	-1	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>	-1
Subtotal	-1	11	19	24	31	38
Technical Reestimates	-2	-7	-5	-6	-6	-5
Enacted Legislation	3	2	2	2	2	2
Thrift Fund Accounting	<u>1</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>
Total	<u>1</u>	<u>9</u>	<u>19</u>	<u>24</u>	<u>31</u>	<u>39</u>
Summer Estimate	1,010	1,080	1,146	1,212	1,280	1,345
Deficit						
Winter Estimate	176	171	164	137	110	84
Economic Reestimates	6	23	35	49	64	77
Technical Reestimates	-28	-16	-13	-16	-15	-16
Enacted Legislation	3	2	2	2	2	2
Thrift Fund Accounting	<u>1</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>
Total	<u>-18</u>	<u>12</u>	<u>27</u>	<u>39</u>	<u>55</u>	<u>67</u>
Summer Estimate	157	183	192	176	165	151

SOURCE: Congressional Budget Office.

NOTE: The winter baseline shown in this table was detailed in *An Analysis of the President's Budgetary Proposals for Fiscal Year 1988* (February 1987).

a. Less than \$500 million.

Recently enacted legislation raises outlays by about \$2 billion a year, as shown in Table II-6. A supplemental appropriation raises outlays for defense and nondefense agencies. The highway bill enacted in early 1987 reduces outlays in all years below the spending projected last February, by amounts ranging from \$400 million in 1988 to \$1.9 billion in 1992. Major banking legislation just enacted by the Congress provides the Federal Deposit Insurance Corporation with additional alternatives for assisting troubled institutions. The new law also replenishes the Federal Savings and Loan Insurance Corporation (FSLIC) fund. Although funds received by the FSLIC will be offset over time by greater disbursements, the lag between obligations and disbursements helps to lower the deficit at first. In total, the banking bill reduces the deficit by an estimated \$650 million in 1988 and by \$1 billion over the entire 1988-1992 period.

A variety of technical reestimates reduce outlays. The largest change occurs in estimates of farm price support programs. Earlier estimates have been revised downward by \$3 billion in 1988, and by diminishing amounts in later years, because of expected greater demand (both domestic and foreign), higher prices, and lower production. Other technical revisions reduce outlays in deposit insurance and Social Security compared with previous estimates. Finally, revised treatment of the new thrift savings plan for federal employees, as recommended by the General Accounting Office, adds \$3 billion a year in outlays in 1988 through 1992 (see box, pages 54 and 55).

Year-to-Year Changes. The baseline estimates of revenues and outlays yield a federal government deficit that spurts from \$157 billion in 1987 to \$183 billion in 1988 and \$192 billion in 1989. Only after 1989 does the deficit slowly decline.

What explains this irregular pattern? To a large extent, budget totals since 1985 reflect the impact of one-time or transitory policy changes. Adjusting the budget for these changes shows a much less dramatic drop in the deficit between 1986 and 1987, but it also smooths the year-to-year gyrations thereafter.

Table II-7 shows the estimated revenue effects of the 1986 Tax Reform Act compared with prior law. In a complex package that cut both individual and corporate income tax rates while repealing the investment tax credit, lengthening asset lives for depreciation purposes, and curtailing tax preferences, the Congress sought to change the income tax mix even while raising approximately the same revenue as prior law. It basically succeeded in this effort: tax reform is approximately deficit neutral after 1990. But in the first few years, transition rules, changing payment schedules, and taxpayer behavior result in large annual fluctuations. In the

TABLE II-7. EFFECT OF TAX REFORM AND ONE-TIME OUTLAY SAVINGS ON DEFICIT (By fiscal year)

	1986	1987	1988	1989	1990	1991	1992
In Billions of Dollars							
CBO Baseline							
Revenues	769	853	897	954	1,036	1,115	1,195
Adjustment for Tax Reform	<u>a /</u>	-20	12	18	5	-2	-4
Adjusted Revenues	769	833	909	972	1,040	1,113	1,191
CBO Baseline Outlays	990	1,010	1,080	1,146	1,212	1,280	1,345
Adjustments for One-Time Savings:							
Due to asset sales and loan prepayments	<u>a /</u>	7	<u>a /</u>	-1	-1	-1	-1
Due to timing shifts	-1	5	<u>a /</u>	<u>a /</u>	<u>a /</u>	<u>a /</u>	<u>a /</u>
Other	3	2	-3	-1	<u>a /</u>	<u>a /</u>	<u>a /</u>
Subtotal	<u>2</u>	<u>15</u>	<u>-2</u>	<u>-2</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>
Adjusted Outlays	992	1,025	1,078	1,144	1,211	1,279	1,344
CBO Baseline Deficit	221	157	183	192	176	165	151
Adjustments	2	35	-14	-20	-6	1	3
Adjusted Deficit	223	192	169	172	170	166	154
Adjusted Revenues, Outlays, and Deficit as a Percent of GNP							
Revenues	18.4	18.9	19.3	19.3	19.3	19.4	19.4
Outlays	23.7	23.3	22.8	22.7	22.5	22.2	21.9
Deficit	5.3	4.4	3.6	3.4	3.2	2.9	2.5

SOURCE: Congressional Budget Office.

a. Less than \$500 million.



THE FEDERAL EMPLOYEES' THRIFT PLAN AND THE BUDGET

As part of a comprehensive retirement reform package affecting federal employees, the Congress in 1986 set up a new thrift plan to collect voluntary contributions from workers and matching contributions from their agencies. The thrift plan is similar to voluntary salary reduction plans (often called 401 (k) plans) that cover many private sector workers. Participants in such plans enjoy certain tax advantages--primarily by deferring taxes on voluntary contributions, matching contributions, and investment earnings. The first contributions flowed into the new plan in early 1987. By June 30, the fund held \$400 million and was growing rapidly.

In establishing a Federal Retirement Thrift Investment Board to administer the new fund, the Congress emphasized that the government's role is purely fiduciary. The fund's assets belong to the participants. But despite its emphasis on the government's limited role, the Congress included the fund's receipts and expenditures in the budget, based on guidance received at that time from CBO and the Office of Management and Budget.

In a letter to a Member of Congress last May, the General Accounting Office (GAO) argued that the thrift fund's receipts and expenditures should not be treated in the budget like those of other agencies. Citing the clear legislative history, the GAO concluded that it is inappropriate for the budget to include monies held strictly in trust for individual workers.

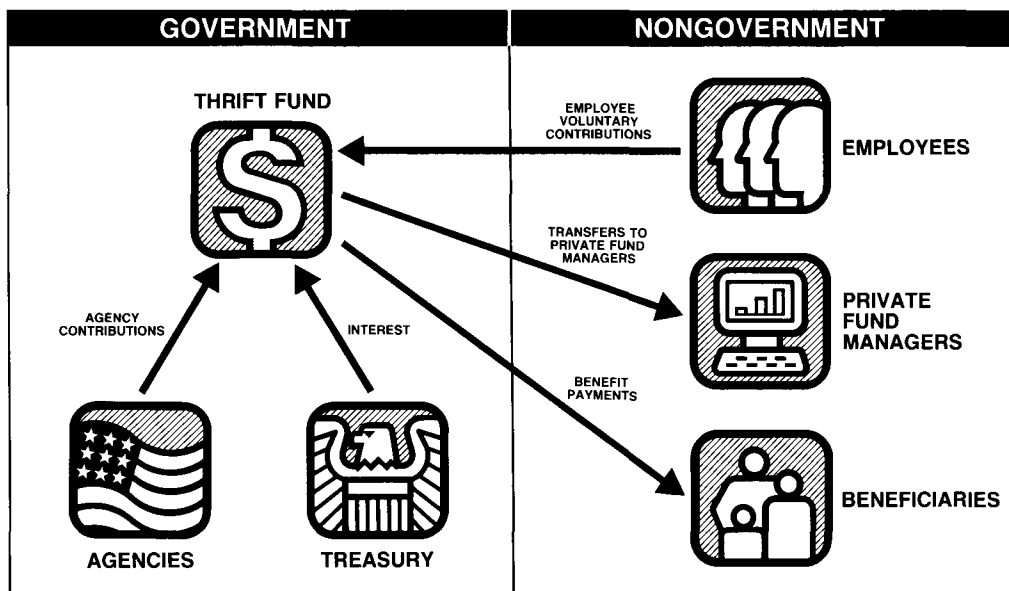
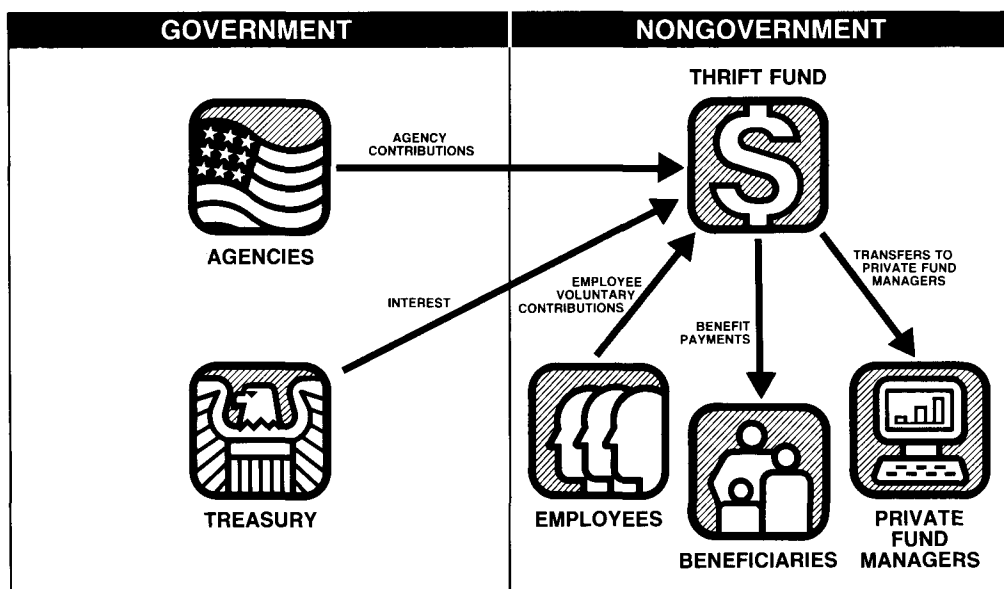
The CBO has followed the GAO's recommendation in its new budget projections. By emphasizing that the thrift fund is not a part of the government, the new treatment changes the classification of four transactions, as shown in the accompanying illustration. Voluntary employee contributions would no longer reduce the deficit, reflecting merely the private investment choices of federal workers. Agency contributions--currently labeled intragovernmental--would instead represent a payment by government to private savers. Similarly, interest paid by the Treasury to the fund is a payment by the government to outsiders. Finally, outlays by the thrift fund would not contribute to the deficit. At present, the fund's outlays for benefit payments, purchase of nongovernment securities, and administrative costs are counted in the budget. But in the proposed approach, these transactions take place among private parties and are not relevant to the government's deficit.

Even while raising the deficit, the new thrift plan treatment has no effect on the federal government's credit demands. The thrift fund will purchase significant amounts of Treasury securities and, over time, of corporate securities as well.

CHANGE FROM PREVIOUS BUDGETARY TREATMENT

	(In billions of dollars)					
	1987	1988	1989	1990	1991	1992
Employee Voluntary Contributions	0.5	1.8	2.0	2.1	2.2	2.3
Agency Contributions	0.6	1.4	1.6	1.8	1.9	2.1
Interest Paid by the Government	a/	0.2	0.4	0.6	0.9	1.1
Outlays by the Thrift Fund	a/	-0.3	-0.7	-1.1	-1.6	-2.0
Total Increase in Deficit	1.0	3.1	3.3	3.4	3.4	3.5

a. Less than \$50 million.

Old Treatment of Thrift Plan**New Treatment of Thrift Plan**

absence of tax reform, federal revenues would be about 18.9 percent of GNP in 1987 and 19.3 percent to 19.4 percent in 1988 through 1992.

Table II-7 also shows unusual, one-time factors affecting outlays in three categories. Asset sales and loan prepayments primarily include sales mandated in the reconciliation bill enacted in fall 1986. Timing shifts reflect the movement of outlays by a few days or weeks between adjacent fiscal years. The government reduced 1987 outlays by accelerating the final payment for general revenue sharing into September 1986, and by delaying military paychecks and certain Medicare payments into 1988. Other one-time factors include the accelerated release of Outer Continental Shelf escrow funds in 1986 and 1987. Without the year-to-year fluctuations shown in the table, projected outlays would decline slowly but steadily as a percent of GNP from 1986 through 1992.

Adjusting the baseline estimates for both tax reform and one-time outlay savings reveals a slow but steady drop in the deficit as a share of GNP from 1987 on. The 1987 deficit improvement looks more modest; the 1988 and 1989 outlooks more favorable.

Sensitivity of the Estimates. Economic conditions vitally affect the federal budget. Wages and salaries, corporate profits, and other economic variables largely determine the federal government's revenues. Outlays for many benefit programs depend on the inflation and unemployment rates, and interest rates--notoriously difficult to forecast--affect the government's cost of servicing its debt of nearly \$2 trillion.

As discussed in Chapter I, the forecast assumes that real economic growth will average about 2.7 percent over the next five years. Lowering the assumption for real growth by one percentage point each year, and taking into account the accompanying higher unemployment, would lead to a hike in the deficit forecast of about \$9 billion in 1988 and \$84 billion by 1992. Raising the assumptions about interest rates for all maturities by one percentage point in every year would cause interest outlays to be about \$5 billion higher in 1988 and \$24 billion higher by 1992. An earlier report, *The Economic and Budget Outlook: Fiscal Years 1988-1992*, contains fuller descriptions and estimates of how these and other economic variables affect the federal budget.

The Congressional Budget Resolution

The policies of the Congressional budget resolution, if fully implemented, would reduce the deficit according to CBO estimates to about \$146 billion in

1988, \$140 billion in 1989, and \$108 billion in 1990 (Table II-8). The budget resolution specifies policies for three years only. Over these three years, deficits average about \$52 billion a year less than in the baseline. About one-half of the deficit reduction comes from revenue increases that were assumed--but not specified in detail--in the resolution. Another 20 percent comes from reducing growth in defense budget authority below the rate of inflation. Because actual defense outlays respond with a lag to changes in appropriations, defense outlays are only \$2 billion below the baseline in 1988 but \$19 billion lower in 1990. (The resolution allows even less defense

TABLE II-8. POLICY CHANGES IN THE FISCAL YEAR 1988
BUDGET RESOLUTION AS ESTIMATED BY CBO
(By fiscal year, in billions of dollars)

	1988	1989	1990
CBO Baseline Deficit	183	192	176
Policy Changes			
Revenue increases <u>a/</u>	-21	-25	-26
Defense	-2	-12	-19
Nondefense discretionary	-4	-6	-8
Entitlements	-3	-5	-7
Offsetting receipts	-1	<u>b /</u>	1
Rural Electrification			
Administration prepayments	-5	1	1
Debt service	<u>-1</u>	<u>-5</u>	<u>-9</u>
Total	<u>-37</u>	<u>-52</u>	<u>-68</u>
Budget Resolution as Estimated by CBO	146	140	108

SOURCE: Congressional Budget Office.

a. Revenue increases appear as negative numbers because they reduce the deficit.

b. Less than \$500 million.



growth in the absence of revenue increases and other reconciliation measures.) The remaining deficit reductions are spread among nondefense discretionary programs, entitlements (especially agriculture and Medicare), and savings on debt service costs.

Reestimates to the Budget Resolution. Table II-9 shows the CBO reestimates to the deficits in the budget resolution. In its report on the budget resolution, the Congress displayed the resolution's targets in two ways—one using the economic and technical assumptions of the President's February budget, and the other using CBO's assumptions of last winter. Deficits were

TABLE II-9. CBO REESTIMATES OF CONGRESSIONAL BUDGET RESOLUTION (By fiscal year, in billions of dollars)

	1988	1989	1990
<hr/>			
Budget Resolution Under CBO Winter Assumptions			
Revenues	922	987	1,077
Outlays	1,055	1,102	1,149
Deficit	134	115	72
CBO Reestimates to Budget Resolution Deficit			
Economic reestimates	23	34	47
Technical reestimates	-13	-12	-14
Enacted legislation	-1	a /	a /
Thrift fund accounting	3	3	3
Total reestimates	12	25	36
Reestimate of Budget Resolution			
Revenues	918	979	1,062
Outlays	1,064	1,119	1,170
Deficit	146	140	108

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

higher under the latter assumptions, and these higher deficits (\$134 billion in 1988, \$115 billion in 1989, and \$72 billion in 1990) are shown as the starting point in Table II-9. Reestimates to the budget resolution, and the accounting adjustment for the federal employees' thrift fund, differ little from the economic and technical updates already described for the baseline, with two major exceptions. First, technical reestimates to the resolution reflect new assumptions about proceeds from prepayment of certain Rural Electrification Administration (REA) loans in 1988. The budget resolution assumed that \$7 billion would be generated by this route, through legislation permitting borrowers to prepay without penalty their high-interest REA loans extended by the federal government (refinancing the loans through private lenders). But because of higher interest rates, the prepayment provisions--if implemented--are likely to generate only \$5 billion in 1988. The other significant difference involves legislative reestimates. Table II-9 includes no legislative reestimates other than the recently enacted bill that recapitalizes the Federal Savings and Loan Insurance Corporation fund. Other recently enacted legislation (for example, the highway bill) was already assumed in the budget resolution or--in the case of the supplemental appropriation bill--comes under binding appropriation ceilings in the resolution.

The budget resolution sets broad priorities for the allocation of federal government spending, assigning Congressional committees to find specific savings in the areas under their jurisdictions. In this analysis of the budget resolution, these savings are treated as targets to be attained through further action. The savings are not reestimated even where they deviate from what would be expected on the basis of assumed appropriations and historical spending patterns.

Federal Sector of the National Income and Product Accounts

Both the budget and the federal sector of the National Income and Product Accounts (NIPA) measure the receipts and expenditures of the federal government. The NIPA federal sector, however, is designed to be more useful than the budget in analyzing the macroeconomic impact of federal government activity. NIPA receipts reflect income of the federal government from various sources, including individual and corporate income taxes, social insurance contributions, indirect business taxes, as well as various fees and payments that are not counted as unified budget revenues. By describing the destination of federal spending--for example, the purchase of goods and services, transfer payments, or grants to state and local governments--the NIPA categories of federal expenditures help economists to trace the impact of the government on final demand and production.



The NIPA estimates of federal government activity differ from the budget in their treatment of certain offsetting receipts, timing adjustments, treatment of lending and financial activities, and coverage. Table II-10 shows estimates of federal-sector receipts on a NIPA basis consistent with CBO's new baseline projections.

Certain payments that appear as offsets to outlays in the budget are instead treated as receipts in the federal sector of the NIPA. By far the largest such payment is contributions by federal government agencies to employee retirement. Other such netting and grossing adjustments apply to payments that reflect voluntary or business-type transactions, such as the supplemental premiums paid by many Medicare participants. Financial transactions, such as bonuses on Outer Continental Shelf land leases, lending, and asset sales, are excluded from the NIPA federal sector, as are transactions involving Puerto Rico and other territories.

The two most important timing differences affect defense spending and taxes on corporate profits. The budget records taxes on corporate profits when payments are made, while the NIPA records them when the liability accrues. Also, NIPA defense purchases reflect the delivery of completed products, while the budget shows payments to contractors (including payments for work in progress).

Differences between the budget and the federal sector of the NIPA are detailed in Table II-11. These adjustments have changed somewhat from those published last February. That earlier report highlighted the different treatment of the new federal workers' thrift fund in the budget and in the NIPA, noting that the NIPA would treat the new plan as part of private savings (just as it treats similar plans in the private sector and state and local governments). The new handling of the thrift plan brings the budgetary treatment close to the NIPA. Last February's report also stated that the delay of military paychecks from September to October 1987 would contribute to the defense timing adjustment, leaving NIPA defense purchases impervious to the few days' delay. Instead, it appears that the Commerce Department will place the savings in a separate reconciliation account (wage accruals less disbursements); thus, defense purchases in the third quarter of 1987 will be lowered by the delay.

TABLE II-10. PROJECTIONS OF CBO BASELINE RECEIPTS AND EXPENDITURES ON A NATIONAL INCOME AND PRODUCT ACCOUNTS BASIS (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Receipts						
Personal tax and nontax receipts	396	401	429	468	508	550
Corporate profits tax accruals	101	112	125	141	147	156
Indirect business tax and nontax accruals	53	54	55	56	58	60
Contributions for social insurance	<u>343</u>	<u>378</u>	<u>404</u>	<u>434</u>	<u>466</u>	<u>495</u>
Total	892	945	1,012	1,099	1,180	1,261
Expenditures						
Purchases of goods and services	372	390	409	430	449	469
Defense	288	295	308	323	338	353
Nondefense	84	95	101	107	111	116
Transfer payments	409	440	475	513	550	591
Grants to state and local governments	104	110	116	121	127	133
Net interest	139	151	161	170	179	183
Subsidies less current surplus of government enterprises	<u>33</u>	<u>34</u>	<u>32</u>	<u>35</u>	<u>34</u>	<u>32</u>
Total	1,057	1,124	1,194	1,268	1,339	1,408
Deficit	164	179	182	169	159	147

SOURCE: Congressional Budget Office.



TABLE II-11. RELATIONSHIP OF THE CBO BASELINE TO THE FEDERAL
SECTOR OF THE NATIONAL INCOME AND PRODUCT
ACCOUNTS (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Receipts						
Total Revenues <u>a/</u>	853	897	954	1,036	1,115	1,195
Contributions for						
Employee Retirement	35	40	43	46	49	53
Medicare Premiums	7	8	9	10	10	11
Other Netting and						
Grossing	8	9	9	9	10	9
Geographic Exclusions	-3	-3	-3	-3	-3	-3
Other	<u>-8</u>	<u>-7</u>	<u>-1</u>	<u>1</u>	<u>-2</u>	<u>-4</u>
Federal Sector NIPA Receipts	892	945	1,012	1,099	1,180	1,261
Expenditures						
Total Outlays <u>a/</u>	1,010	1,080	1,146	1,212	1,280	1,345
Lending and Financial						
Transactions	-4	-7	-9	-6	-4	-4
Contributions for						
Employee Retirement	35	40	43	46	49	53
Medicare Premiums	7	8	9	10	10	11
Other Netting and						
Grossing	8	9	9	9	10	9
Defense Timing						
Adjustment	7	3	3	3	3	3
Bonuses on Outer						
Continental Shelf						
Land Leases	1	1	<u>b /</u>	<u>b /</u>	<u>b /</u>	<u>b /</u>
Geographic Exclusions	-6	-6	-6	-7	-7	-7
Other	<u>-2</u>	<u>-4</u>	<u>-2</u>	<u>b /</u>	<u>-2</u>	<u>-3</u>
Federal Sector NIPA Expenditures	1,057	1,124	1,194	1,268	1,339	1,408

SOURCE: Congressional Budget Office.

a. Includes Social Security, which is off-budget.

b. Less than \$500 million.

CHAPTER III

UNCERTAINTY AND BIAS IN

BUDGET PROJECTIONS

Large deficits and statutory deficit targets have heightened concerns about the uncertainty of budget projections. The Grassley amendment to the Deficit Reduction Act of 1984 directed the Congressional Budget Office (CBO) to study the reliability of the budget resolution estimates. The situation that led to this amendment arose again in 1987, after lawmakers who had concluded the 99th Congress believing they had met the goals of the Balanced Budget Act returned in January to find that the deficit estimate had risen again.

These concerns have prompted the present chapter, which reviews the accuracy of Congressional budget estimates and CBO economic forecasts during the 1980s. For the reader who wants a quick overview of the findings, the first section summarizes the analysis. The following sections describe and quantify the sources of error in budget resolution estimates in more detail. The chapter concludes with a discussion of the range of uncertainty in deficit estimates.

OVERVIEW

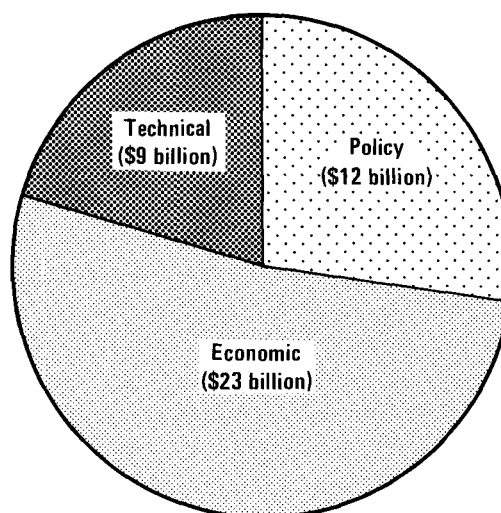
Congressional budget resolutions during the 1980s have underestimated the actual deficits by an average of \$44 billion--about 6 percent of outlays or 7 percent of revenues. Every year the deficit exceeded the budget resolution target, with errors as large as \$91 billion in fiscal year 1983 and as small as \$4 billion the following year. The deficit underestimate for 1987, with 45 days of the current fiscal year remaining, appears to be about \$15 billion; but as recently as 1986 the underestimate was \$49 billion. Policy differences, inaccurate economic assumptions, and inaccurate technical estimating methods have all contributed to the deficit errors, as shown in Figure III-1 on the next page.

The budget resolution is a plan for guiding subsequent tax and spending decisions. Policy differences--failure to implement policies assumed in the budget resolutions--have played a role in increasing the deficit in six out of the last eight years. The average policy difference of \$12 billion is accounted for by higher spending. In the early 1980s, the bulk of the spending overruns were in defense and nondefense discretionary appropriations. In later years, higher entitlement spending and lower offsetting receipts have been the major factors.

Inaccurate economic assumptions have been the greatest source of error in the deficit estimates. For example, when the budget resolution estimate of the gross national product (GNP) is too high, revenues are overestimated and the deficit underestimated. During the 1980s, errors in forecasting GNP and other economic variables have been responsible for underestimating the deficit by \$23 billion per year. In 1982 and 1986, the budget resolution conferees used economic assumptions more optimistic than those of CBO. Had they used CBO economic assumptions, the average error would have been somewhat less--\$20 billion--but still large. There are two major reasons for these economic errors:

Figure III-1.

Sources of Error in Deficit Estimates, Fiscal Years 1980-1987



SOURCE: Congressional Budget Office.